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ORIGINAL

Decision No. 67960

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the matter of the Application of the Los Lomas Water Company, Inc., for authority to increase water rates in the unincorporated territory served near Watsonville, Monterey County, California.	Application No. 45954 (Filed November 13, 1963)

Thomas K. Perry, for applicant.
John J. Gibbons and John D. Reader, for the Commission staff.

O P I N I O N

Applicant requests an increase in metered water service rates for residents of the Los Lomas Tracts in the Hall District of Monterey County, comprising an area of about 800 acres located approximately three and one-half miles southeast of Watsonville.

The tracts were subdivided into home sites in 1938 by the John T. Porter Company, which installed the initial system pursuant to a certificate of public convenience and necessity granted in 1941 (Decision No. 33842, January 28, 1941, Application No. 23709). The present owner, Clayton B. Neill, acquired the stock of the utility from the original owner about 12 years ago. Neill also owns and operates three other water utilities in Monterey County; the Village Hardware Store in Carmel, which purchases materials and supplies for the utilities, and a consulting engineering firm, Neill Engineers, which provides most of the operational service for the utilities.

The application was heard and submitted, after due notice, on May 7, 1964 at Watsonville before Examiner Gregory.

Applicant served 290 customers as of April 30, 1964. This represents an increase of about 10 percent annually since present rates became effective on July 1, 1960 (Decision No. 60241, June 6, 1960, Application No. 41872). The proposed rates are about 30 percent higher than present rates and would result in a larger percentage increase in charges to smaller users than to larger customers. Basic metered service rates would be increased from $2.80 per month, allowing 700 cubic feet or less of water, to $3.50 per month for 500 cubic feet or less. No increase is requested in existing rates for public fire hydrant service. Details of the system and service are included in the application.

Applicant asserts that a serious situation faces the Company over the coming years, due to general rising costs and because of "excessive" extraordinary expense, approximating $8,000, for relocation of mains, services and facilities occasioned by the rebuilding of Hall Road (a main route connecting Watsonville and Prunedale) through the center of the community. Applicant also plans, if funds are available, to spend about $3,100 for deferred maintenance and $26,120 for capital improvements.

Applicant's showing at present rates, based largely on its recorded experience in 1962 and 1963 (with certain adjustments), updated to include the first four months of 1964, would seem to indicate that the system has been operating with a substantial deficit for some time and that an increase in rates is justified.[1/] Applicant has estimated that the proposed rates, if in effect for 1963 and 1964, would produce net revenues, after depreciation and taxes, of approximately $2,100 for each of the two years and rates of return of

1/ The adjustments include "usual" operating expenses of $3,422.55, as yet unpaid, and $4,699.50 of "extraordinary" expense for materials and contract work caused by the Hall Road reconstruction, also unpaid, or total unpaid expenses of $8,122.14 on April 30, 1964, together with $8,145.74 of current accounts payable as of that date.

6.88 percent and 6.82 percent, respectively, on rate bases unadjusted for a requested downward revision of $4,241.49 in depreciation reserve alleged to have resulted from excessive depreciation expense charged by the utility between 1941 and 1952. Rates of return on rate bases adjusted to include the downward revision of depreciation reserve are, according to applicant's estimates, 6.00 percent for 1963 and 5.98 percent for 1964 at the proposed rates.

The record shows that the staff's investigation of applicant's books in the development of its operations report (Exhibit 11) was hampered, to a degree, by refusal of applicant's president to make available original invoices for supplies purchased from affiliated interests, involving markups asserted by applicant's president to range from five to ten percent. This refusal to make such records available would, in itself, be sufficient to warrant denial of the application, since it is applicant's obligation fully to disclose all facts underlying its claim of justification for increased rates. In this case, however, it is not likely that the dollar amounts of such markups have been large, because the total plant additions since 1955 have amounted to only $17,039. Moreover, as the application must be denied for other reasons, the question of non-disclosure of dealings with affiliates will not be considered, in this instance, as determinative of our action.

Although applicant's records appear generally to conform with the uniform system of accounts prescribed by this Commission for water utilities, the staff, in its study of applicant's financial statements, has made certain adjustments for unrecorded accruals for depreciation, interest and income taxes. Also, although not taking exception to the amounts (totalling $358.24) of capitalized construction overheads for 1960, 1961 and 1962, derived by applicant by adding arbitrary percentages to utility plant accounts for those years, the staff points out -- and we note -- that the Uniform System of Accounts (Plant Instruction 6B, p. 43) specifically prohibits the addition of arbitrary percentages to utility plant accounts to cover assumed overhead costs. Applicant's present practice and method of capitalizing overheads does not conform to prescribed accounting procedure and should be revised.

With respect to depreciation reserve, the record reveals that the Commission, in the 1960 rate application, considered the same request for a depreciation adjustment made here and found that periodic reviews using the straight-line remaining life method would provide for the reasonable recovery of the original cost of depreciable plant without need for such adjustment. The present record suggests no reason to depart from our former conclusions concerning this item.

With regard to depreciation expense, the staff computed the estimated depreciation expense for 1963 and 1964 using the straight-line remaining life method and a composite depreciation rate of 2.86 percent on beginning-of-year plant plus average additions during the year. Applicant has been calculating depreciation expense by the same method, using that composite rate since 1959 applied, however, to its end-of-year plant figures. That practice should be discontinued and, instead, applicant should use either beginning-of-year or average utility plant balances for determination of depreciation accruals.

The record shows that operating expenses in 1962 and 1963 have increased, as compared with 1961, largely because of increases in amounts paid to applicant's officers and to employees of an affiliate, Neill Engineers. Expenses in 1962 also were affected by increased expenditures for well and pump maintenance, classified by applicant as "outside contract services." Billings by the engineering firm to the water company, commencing in 1962, have been made at an hourly rate of $5.10. Applicant did not disclose pertinent information necessary for determination of the reasonableness of such charges for purposes of this proceeding, or the extent to which, if any, the hourly rate includes a profit element for the engineering firm.

Much of the record is concerned with the Hall Road relocation project and its effect on the utility's operations and financial condition. Applicant has expensed most of the utility's costs attributable to that project, pending determination of their accounting treatment in this proceeding.

It appears, from applicant's testimony, that total expenditures incurred in connection with the highway relocation may approximate $8,000 and that a substantial portion of the total was occasioned by the adverse conditions under which replacement mains were installed. Under these circumstances, a portion of the total may properly be charged to operating expenses. Even if the amount chargeable to operating expenses were as high as $3,000 or $4,000, however, and if such amount were distributed over a five-year period for rate-making purposes, earnings under present rates would still be fully adequate. Provision will be made in the order herein for what we find to be the reasonable accounting treatment to be accorded to the various items involved.

Shown below, in condensed form, are estimated operating results for 1963 and 1964 , at present and proposed rates, as indicated by the staff study, including certain adjustments shown in detail in the study and giving effect to inclusion in expenses of $3,000 (amortized over five years) and in plant of $5,000 of the $8,000 attributable to the highway relocation project, and as shown by applicant's estimates, at proposed rates, based on its consumer use study for twelve months ending September 30, 1963. The staff applied a factor of 10 percent for customer increase, while applicant used 5 percent.

Item	Staff: 1963 Estimated Present Rates	Staff: 1963 Estimated Proposed Rates	Staff: 1964 Estimated Present Rates	Staff: 1964 Estimated Proposed Rates	Applicant: 1963 Est. Proposed Rates	Applicant: 1964 Est. Proposed Rates
Operating Revenue	$15,070	$19,720	$16,620	$21,740	$18,900	$19,850
Additional Amortization	400	400	400	400	-	-
Operating Expenses	9,880	9,880	10,620	10,620	13,658	14,261
Depreciation Expense	1,620	1,620	1,690	1,690	1,506	1,621
Taxes Other Than on Income	620	620	690	690	{1,650	{1,786
Taxes on Income	340	1,563	516	1,863		
Total Deductions	12,860	14,083	13,916	15,263	16,814	17,668
Net Revenue	2,210	5,637	2,704	6,477	2,086	2,182
Average Depreciated Rate Base	34,600	34,600	35,400	35,400	30,400 (A)	32,000 (A)
Rate of Return	6.4%	16.3%	7.6%	18.3%	6.88% (A)	6.82% (A)

(A) Unadjusted. If rate base and rate of return were adjusted by downward revision of $4,241.49 in depreciation reserve, as requested by applicant, the comparable figures would be: 1963, $34,900 and 6.00%; 1964, $36,500 and 5.98%. (Application, Exhibit "J")

We find that the staff's adjusted estimates of results of operation for 1963 and 1964, as indicated in its study and as calculated to include its treatment of the $8,000 expenditures for the Hall Road project, are reasonable and they are hereby adopted for the purposes of this proceeding. Those results indicate that earnings under present rates are fully adequate. Accordingly, we find, on this record, that applicant has not justified its request for an increase in rates. Certain recommendations by the staff, relating to accounting treatment for the Hall Road expense, to determination of depreciation accruals by applicant and to a revision in its bill form to include the wording required by its filed Rule No. 5, are reasonable and their execution by applicant will be provided for in the ensuing order.

O R D E R

IT IS ORDERED that:

1. Applicant, for accounting purposes in connection with expenditures due to the Hall Road relocation work referred to in the foregoing opinion, shall:

   (a) Charge to Account No. 250, Depreciation Reserve, the original cost of plant removed from service as a result of the highway relocation work;

   (b) Charge to appropriate plant accounts the estimated costs of replacement plant facilities that would have been incurred under normal working conditions;

   (c) Charge to maintenance expenses the difference between the amount charged to plant accounts and the total amount expended.

2. Applicant shall discontinue the practice of determining depreciation accruals on the basis of end-of-year utility plant balances and, instead, shall use either beginning-of-year or average utility plant balances.

3. Applicant shall revise its bill form to include the wording required by its filed Rule No. 5, and within forty-five days after the effective date of this order shall file such revised bill form with the Commission. Such filing shall comply with General Order No. 96-A, and the revised tariff sheet, if acceptable to the Commission, shall become effective on the fourth day following the date of filing.

4. Applicant shall exclude from plant accounts all markups resulting from transactions with affiliates and shall discontinue

such markups in the future unless their basis is adequately supported and fully disclosed in a manner acceptable to the Commission.

5. The application herein for an increase in rates for water service is denied.

The effective date of this order shall be twenty days after the date hereof.

Dated at San Francisco, California, this 6th day of OCTOBER, 1964.

Frederick B. Holoboff
President

Peter E. Mitchell Jr.

William M. Bennett

Commissioners

I concur in the order.
George G. Grover

Commissioner Everett C. McKeage, being necessarily absent, did not participate in the disposition of this proceeding.